STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 2001-434

July 17, 2001

BANGOR HYDRO-ELECTRIC COMPANY
Request for Approval of a Special Rate Contract
Lincoln Pulp and Paper Company, Inc.

ORDER APPROVING
STIPULATION (PART II)

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

I. SUMMARY

By this Part II Order, we explain our reasoning in approving a Special Rate Agreement between Bangor Hydro-Electric Company (BHE) and Lincoln Pulp and Paper Company (Lincoln) and a Stipulation entered into between BHE, Lincoln and the Office of the Public Advocate (OPA). Further, we explain our rationale in granting waivers to the requirements that Lincoln pay BHE an opt-out fee pursuant to Chapter 301, section 2(c)(2)(d) and that BHE receive at least 48 hours notice that Lincoln is transferring out of standard offer service pursuant to Chapter 301, section 2(D)(4).

II. BACKGROUND

BHE and Lincoln entered into a Power Sales Agreement (PSA), a special rate contract for electric utility service, dated December 31, 1996. The Electric Restructuring Act, 35-A M.R.S.A. § 3201-3217, prohibits BHE from providing generation services, effective March 1, 2000. Accordingly, the parties were required to renegotiate and reform the PSA in a manner as directed by 35-A M.R.S.A. § 3204(10). The reformation process produced Amendment No. 2 to the PSA. By the second amendment, BHE agreed that Lincoln acted diligently in obtaining generation service from Enron Energy Services, Inc., and that the PSA should be "unbundled" by subtracting the Enron generation price from the PSA contract price. By order dated June 16, 2000 (Docket No. 2000-180), the Commission approved a stipulation between BHE, Lincoln and the Office of the Public Advocate that recommended approval of the second amendment and recommended that the Commission waive certain rules to allow BHE to allocate to Enron $300,000 of Lincoln's payments to BHE. These additional funds, that by our rule should have been allocated to T&D service, were instead used to serve as the deposit Enron required from Lincoln, assuring that Lincoln could maintain generation service from Enron.

Lincoln's generation contract with Enron terminated on February 28, 2001, but Enron continued to provide Lincoln generation service through Lincoln's meter read date, March 31, 2001. Lincoln filed for protection under Chapter 11 of the U.S. Bankruptcy Code on September 11, 2000, and states that it has been unable to secure a new generation service contract with a competitive electricity provider (CEP), at a

price below BHE's current standard offer price. Accordingly, since April 1, 2001, Lincoln has been taking generation service from the standard offer provider, BHE, at a rate of about 7.7¢/kWh. The original PSA bundled rate varies monthly based on the daily mean spot price for oil and is estimated currently at approximately 6.0¢/kWh.

Since March, Lincoln, BHE, the OPA and Commission staff have attempted to deal with the issues raised by the need to unbundle the PSA for a new generation supply arrangement, including whether section 3204(10) requires or even permits "negative payments" for T&D service and the due diligence implications of Lincoln's remaining on standard offer service. All parties agree that customers exhibiting Lincoln's load characteristics should generally be able to obtain lower-priced generation service from a CEP than through the standard offer provider. The parties were instructed by the Commission that Lincoln should explore service from a CEP, even if such service might require BHE to provide credit guarantees. Lincoln also expressed an interest in exploring a longer term arrangement which would eliminate any negative contribution in the first year, thereby providing a benefit to BHE, and that would provide more stable electricity prices over a number of years, thereby enhancing the prospects for a successful Chapter 11 plan of reorganization for Lincoln.

After months of meetings and negotiations, on June 27, 2001, BHE, Lincoln and the OPA filed a stipulation and a new special rate contract. As part of the Stipulation, BHE and Lincoln agree to terminate the original PSA and to execute a new special rate contract, called the Special Rate Agreement (the New Agreement). The term of the New Agreement is through March 31, 2006. For the initial period of July 1, 2001 through March 31, 2002, Lincoln receives the benefits of the PSA, which means that Lincoln will receive delivered energy and capacity for about 6¢/kWh, and BHE will bear the power supply cost risks in this period. Lincoln agrees that it will acquire power during the initial period from a CEP, and that BHE will provide a credit guarantee to that CEP. The CEP will supply Lincoln power in the manner chosen by BHE to minimize the power supply costs. BHE's lowest cost strategy is to acquire a power strip that represents about 87% of Lincoln's expected energy requirement and the remaining 13% on the energy spot market. BHE will be obligated to purchase the power strip regardless of the level of Lincoln's operation. BHE expects to purchase ICAP in the bilateral market. BHE estimates that Lincoln's power supply costs in the initial period will be less than 6¢/kWh, eliminating the negative payment controversy.

During the second period of the New Agreement, April 1, 2002 through March 31, 2006, Lincoln will have the option of seeking one-year full requirements generation service contracts for which BHE will provide an unconditional credit guaranty and a take-or-pay provision. In any year that Lincoln invokes BHE's credit guaranty, Lincoln must exercise due diligence to obtain the lowest price contract. If BHE believes that Lincoln did not exercise due diligence, BHE may petition the Commission to resolve the matter. Both parties agree to be bound by the Commission's determination.

Lincoln's T&D price during the second period will be based upon a profit-based index. The index will have a minimum price of BHE's FERC-approved Open Access

Transmission Tariff (OATT). The index uses a proxy of Lincoln's profits by choosing a base year, establishing revenue based upon the published price indices for three paper products and subtracting cost estimates of Lincoln's major cost components determined by using readily-available government or privately determined published data.[1] As this proxy of profitability goes up, the index produces higher T&D prices.

During the second period, Lincoln will also pay BHE an additional amount if Lincoln's combined generation cost and delivery cost is less than 6.2¢/kWh. The additional amount paid to BHE will be 60% of the product of Lincoln's total kWh usage for the year multiplied by the difference between 6.2¢/kWh and Lincoln's combined generation plus delivery costs stated as a per kWh cost.

In the New Agreement, Lincoln agrees that self-generation cannot reduce the kWhs purchased by Lincoln for delivery service from BHE in any calendar year to an amount less than the average annual kWh usage from 1998-2000. Lincoln also agrees that, in the initial period and when it employs the BHE credit guaranty in a second period power supply arrangement, Lincoln will pay for T&D service every two weeks by electronic funds transfer (EFT).

The Stipulation is conditioned on both Commission and U.S. Bankruptcy Court approval of the New Agreement. The stipulating parties state that in order for BHE and Lincoln to perform their obligations under the New Agreement, Lincoln will need a waiver of the standard offer opt-out fee in Chapter 301 of our Rules. In addition, Lincoln needs a waiver of the Chapter 301 requirement that a T&D utility receive notice of a standard offer customer transferring to a CEP 48 hours in advance of the transfer.

We issued a Part I Order on June 27, 2001, in which we approved the Stipulation and the New Agreement. We also granted the Chapter 301 waivers requested. In this Part II Order, we explain our reasoning in reaching these decisions.

III. DECISION

In past cases, we have applied the following criteria when considering stipulations:

1. whether the parties joining the stipulation represent a sufficiently broad spectrum of interests that the Commission can be sure that there is no appearance or reality of disenfranchisement;

2. whether the process that led to the stipulation was fair to all parties; and

[1] Because the index contains information on the relative amounts of Lincoln's various cost inputs, the index formula involves confidential, proprietary and sensitive business information. Accordingly the index formula is subject to a protective order.

3. whether the stipulated result is reasonable and is not contrary to legislative mandate.

See Central Maine Power Company, Proposed Increase in Rates, Docket No. 92-345(II), Detailed Opinion and Subsidiary Findings (Me. P.U.C. Jan. 10, 1995), and *Maine Public Service Company*, *Proposed Increase in Rates* (*Rate Design*), Docket No. 95-052, Order (Me. P.U.C. June 26, 1996). We have also recognized that we have an obligation to ensure that the overall stipulated result is in the public interest. *See Northern Utilities, Inc., Proposed Environmental Response Cost Recovery*, Docket No. 96-678, Order Approving Stipulation (Me. P.U.C. April 28, 1997). We find that the Stipulation in this case meets all of the above criteria.

BHE, Lincoln and the OPA have jointed the Stipulation. Generally, we find that special contract proceedings do not involve issues of substantial public interest sufficient to warrant public notice and opportunity to intervene as provided in Chapter 110, § 712.[2] Moreover, the nature of the business arrangements between the customer and utility (and generation supplier) often require expedited review. The utility, the customer and the public agency that serves the interests of ratepayers represent the entire spectrum of interest in this matter.

All parties have joined the Stipulation; therefore they must accept that the process that led to the Stipulation was fair. We note that members of the advisory staff participated in many of the discussions and meetings that led to the Stipulation, which means that all parties received notice of and the opportunity to attend those meetings.

Finally, we find that the Stipulation represents a fair and reasonable resolution to the issues facing BHE, Lincoln and ratepayers. The unbundling of the new generation arrangement from Lincoln's PSA is subject to reconciliation by the Stipulation in Phase II of BHE's initial T&D rate case (Docket No. 97-596). Thus, during the initial period (at least through February 28, 2002) the T&D contribution, positive or negative, will become a benefit or burden to BHE's ratepayers.

In addition, maintaining a revenue contribution from Lincoln beyond March 31, 2002 is important to BHE and its customers. With the closure of the Holtrachem facility, Lincoln is BHE's second largest customer. As such a large customer, Lincoln can have a significant impact on the level of BHE's core rates. It is, therefore, important to BHE and its ratepayers to promote the viability of Lincoln in order to maximize its contribution toward BHE's fixed costs.

[2] In this sentence, we refer to special contract approval requests that are brought pursuant to section 703 and not part of a pricing flexibility plan approved as part of an alternative rate plan. In such a pricing flexibility plan, minimal notice and review is generally required. The New Agreement is not brought to the Commission as part of BHE's pricing flexibility plan.

Because electricity is a significant cost to Lincoln's business, assurance of a stable, reasonably-priced source of electricity is important to Lincoln's viability, particularly considering Lincoln's status as an entity currently under the protection of Chapter 11 of the Bankruptcy Code. This New Agreement provides that stability and should, therefore, allow BHE to maximize its contribution toward fixed costs from Lincoln.

During the initial period, the New Agreement assures that Lincoln receives the benefits of the PSA, as 35-A M.R.S.A. § 3204(10) directs, namely bundled electricity at approximately 6¢/kWh. Lincoln's power supply arrangement in this period is structured to minimize costs and therefore maximize contributions to core ratepayers. Ratepayers' assumption of the credit, take-or-pay and spot market price risks are reasonable in this context. The two-week EFT requirement minimizes credit risk. The risk that Lincoln will not operate for the next nine months does not appear large. Further, the chance that the price of the 10 MW power strip, estimated at current forward prices, will become uneconomic to a significant degree also appears small, as does the risk that the spot market price for 13% of Lincoln's requirements could increase significantly enough to offset the savings achieved by having Lincoln leave the standard offer.

Moreover, the New Agreement provides the benefit of continued T&D contribution by Lincoln into the second period. A base level of contribution, although small, is guaranteed as long as Lincoln operates. Moreover, as Lincoln's viability and profitability improves, so does its T&D contribution. The concept of profit-sharing when financial viability is in question is sound. Using an index that defines profitability under objective rather than subjective measurements with publicly-available data should generate less disagreement and controversy and therefore is also wise. The addition of more contribution if the "re-bundled" electricity cost to Lincoln falls below 6.2¢/kWh also confers benefits to BHE and ratepayers.

Ratepayers assume some risks in the Second Period because of the potential credit guaranty and the take-or-pay requirement if Lincoln ceases operation. We believe those risks are greatly mitigated by the fact that any power supply contract will be for no more than 12 months. The credit risks are also limited by the two-week EFT requirement. The availability of BHE's credit guaranty and assumption of take-or-pay obligations will be important in increasing the ability of Lincoln to achieve an acceptable plan of reorganization and then successfully executing that plan. The Public Advocate's joining of the Stipulation reflects that he must also assess the benefits to ratepayers as clearly outweighing the risks imposed on them. We conclude that the stipulated result, the New Agreement, is reasonable, will serve the public interest, and should be approved as a special rate contract pursuant to 35-A M.R.S.A. § 703(3-A).

The Stipulation also requires that we waive the standard offer opt-out-fee that Lincoln would otherwise owe to BHE for leaving the standard offer on July 1, 2002. That fee was included in Chapter 301 as a means to deter customers from gaming between standard offer and the market depending on price differences between the two.

That is clearly not the situation in this instance. We will, therefore, waive the opt-out fee requirement for Lincoln in this instance.

Finally, the agreement requires us to waive the requirement that the CEP provide 48-hours notice that Lincoln will be leaving the standard offer. We will grant this waiver as we see no reason not to when the T&D utility, in this instance BHE, has no objection to receiving less than 48-hours notice.

The necessary ordering paragraphs were stated in the Order Part I and do not need to be repeated.

Dated at Augusta, Maine, this 17th day of July, 2001.

BY ORDER OF THE COMMISSION

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Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Nugent
Diamond

This document has been designated for publication.

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.